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ARIZONA CORPORATION COMMISSION
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IN THE MATTER OF THE APPLICATION OF
ARIZONA PUBLIC SERVICE COMPANY FOR
A HEARING TO DETERMINE THE FAIR
VALUE OF THE UTILITY PROPERTY OF THE
COMPANY FOR RATEMAKING PURPOSES,
TO FIX A JUST AND REASONABLE RATE OF
RETURN THEREON, TO APPROVE RATE
SCHEDULES DESIGNED TO DEVELOP SUCH
RETURN, AND FOR APPROVAL OF
PURCHASED POWER CONTRACT

DOCKET NO. E-01345A-03-0437

Arizona Corporation Commission

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**RESPONSE OF ARIZONA PUBLIC SERVICE COMPANY IN OPPOSITION
TO MOTION OF ARIZONA COMPETITIVE POWER ALLIANCE**

Arizona Public Service Company ("APS" or "Company") hereby files its Response in Opposition to the Motion of the Arizona Competitive Power Alliance ("Alliance"), which Motion seeks to delay consideration of the Company's Application and to modify the timing and content of the outstanding APS Request for Proposals ("RFP"). The Alliance's Motion is both a legally baseless eleventh-hour delaying tactic that will irreparably damage APS and a transparent attempt to control or even cripple the Company's resource procurement process through a litigation stratagem that will inevitably prove harmful to both APS and APS customers. For the reasons set out below, the Alliance Motion should be denied by the Arizona Corporation Commission ("Commission"), and both the Commission's consideration of the rate Application and the Company's RFP process should be permitted to continue as presently scheduled.

I. INTRODUCTION

The Company has significant needs for additional generating capacity in order to assure reliable electric service to its nearly one million customers and to continue its support of economic growth in Arizona. Therefore, APS announced plans for an RFP on November 19, 2003 and formally issued the RFP on December 3, 2003. On December 15th, the Company concluded a successful bidders' conference involving some nine interested generators and energy marketers, including several members of the Alliance. At no time did any of the Alliance's members or the Alliance itself suggest that the RFP had any connection with the Company's rate proceeding, which has been pending since the end of June 2003 and has had a procedural schedule in place since August 2003. Neither did any member of the Alliance nor the Alliance itself request any substantive change to the scope or timing of the RFP. In fact, a number of the attendees at the bidders' conference were both complimentary of the RFP itself and excited about the prospect of participation. To this date, no individual merchant generator has informed APS of any issue with either the rate case schedule or the RFP.

But now, some six days before Christmas and just three weeks from when Commission Staff and intervenors are scheduled to submit the bulk of their pre-filed testimony, the Alliance suddenly asserts a heretofore undiscovered link between the ongoing RFP and the Company's long-pending rate case. With this pretext firmly in hand, the Alliance goes on to urge the Commission to convert the Company's RFP process from an important and timely resource procurement activity into just another litigation front in the battle over unification of the Pinnacle West Energy Corporation ("PWEC") generating assets at APS. Without bothering to cite even the flimsiest of authority for its propositions, the Alliance suggests a four month delay in the hearing on the Company's rate Application and an impossibly-abbreviated revised RFP schedule that would prevent meaningful and thoughtful evaluation of what hopefully will be a wide array of robust

1 bids from the merchant power community and subsequent negotiation of ~~final~~ final
2 agreements committing hundreds of millions of dollars. Both of the Alliance's proposals
3 reflect either a misunderstanding or a serious distortion of the Company's RFP and of its
4 arguments in support of rate-basing the generation APS would acquire from PWECC.

5 6 II. THE RFP

7 1. The Scope and Timing of the Company's RFP does not Depend Upon 8 the Commission's Ratemaking Treatment of the PWECC Assets

9 The Alliance argues that "[T]he RFP is too small in scale" and is limited to 500
10 MW. (Motion at 9.) This is simply untrue. The RFP is for a minimum of 500 MW, but
11 there is no maximum limit on the amount of resources that may be offered or accepted—a
12 point that was made explicitly in the RFP itself and repeatedly emphasized during the
13 bidders' conference. APS's own long-range forecast ("LRF"), which was provided as part
14 of the RFP and is attached hereto, shows a peak capacity deficit of over 1400 MW in 2007
15 (even after acquisition of the PWECC generation), with the deficit growing to some 3000
16 MW by the end of the forecast period in 2012. It is true that the Company's LRF
17 recognizes that the PWECC assets exist and that it is part of the Company's long-
18 announced plan to acquire these assets. That APS's own LRF is consistent with its own
19 rate Application should have come as no surprise to anyone, least of all the Alliance. After
20 all, these very assets were constructed for the use and benefit of APS customers and
21 allowed the Company to avoid the market pitfalls of those who both found themselves
22 short of capacity in 2000-2001 and without the assurance that new dedicated plants were
23 coming on line in the near future. However, the salient fact is that whether the
24 Commission allows APS to rate base 1700 MW of PWECC generation or none, it would
25 not alter the scope or schedule of the Company's present RFP in the slightest detail. This
26 is necessarily true because APS will conclude this particular resource procurement before
it knows the outcome of the rate case. And independent of what that outcome is, APS will

1 have to seek additional resources in the near future, especially if sufficient amounts are
2 not forthcoming as a result of the current RFP.¹

3 **2. The Timing and Schedule of the RFP are Driven by APS Customer**
4 **Needs and the Present State of the Merchant Generation Industry**

5 To suggest that APS has somehow schemed to use the RFP to “prejudice” its rate
6 proceeding (Motion at 3) is ludicrous. Indeed, the need by the Company to divide its
7 attention between both a critical rate request and this major long-term power procurement
8 can “prejudice” only itself. But as APS has explained in the current RFP, it has a very
9 serious and growing generation capacity resource deficit, especially after the expiration
10 of the Track B contracts. That same Track B proceeding found in no uncertain terms that
11 “APS [and TEP] are responsible for providing for the continuing need of their ratepayers
12 to maintain a reliable supply of electricity at reasonable rates.” Decision No. 65743
13 (March 14, 2003) at 72. As the Commission and the Alliance’s members know, planning,
14 siting, building, permitting, financing and/or otherwise acquiring new resources to ensure
15 reliability is a complex process with long lead times (sometimes three years or more for
16 certain potential project options). And because APS cannot and will not simply assume
17 that reliable future resources will be forthcoming from the market at reasonable prices, it
18 must act to establish the depth of that market while there is still time to consider all
19 options, including that of constructing new utility-owned generation. To wait, as would
20 be the result of granting the Alliance Motion, until certain options have been foreclosed
21 by the passage of time would be an imprudent gamble that APS will not willingly take
22 and to which it will not voluntarily subject its customers. It must be remembered that
23 despite the optimistic hopes of many and the widespread participation by the merchant

24 ¹ The RFP is explicitly targeting specific long-term resource additions (primarily existing “steel in the
25 ground,” either through outright purchase or through long-term contract). However, the Company’s overall
26 resource plan will evaluate other potential supply resources such as shorter-term purchases, spot market
transactions, new-build projects, additional transmission, demand-response and distributed generation
programs, etc. Thus, the present RFP is not, and was never intended to be, the sole means by which APS
would evaluate and procure resources for its customers’ growing needs.

1 power industry in the Track B proceeding, the actual Track B procurement produced
2 insufficient bids from non-affiliated parties to meet even the Company's short-term
3 needs, let alone long-term requirements. And because fully half of the Alliance's
4 members did not participate in the Company's Track B bidding, APS has no guarantee
5 that the present RFP will produce materially better results. (See also Motion at 14.)

6 Ironically, the other driving force behind the present RFP's timing is the merchant
7 power community itself. Several members of the Alliance are actively attempting to
8 divest their Arizona power plants as soon as possible. One has already done so. If APS
9 had waited until after the rate case was decided (or to some other time of the Alliance's
10 choosing) to issue its RFP, it is certainly more than possible that one or more of these
11 plants will already be sold, and logic would tell us that the most eager sellers (who might
12 make APS the most attractive offers) are the least likely to wait until the Alliance
13 believes APS should have conducted its solicitation. Even if one were to assume that no
14 otherwise viable option would be lost through delay, there could still be substantial harm
15 to APS and its customers if intervening events cause the cost of exercising such option to
16 increase. For example, the delay in completing the Track B process from December 2002
17 (as originally envisioned) until April 2003 saw market prices at Palo Verde increase
18 between 27-45%. See APS Report on the Track B Solicitation Process (May 27, 2003) at
19 27.

20 **3. The RFP Process will not Provide APS with Information About the**
21 **Wholesale Market that is not Already Known by the Alliance**
and/or Its Members

22 The Alliance appears to consider the Company's RFP to be nothing more than an
23 intelligence-gathering exercise that APS will, in some undisclosed manner, use in
24 formulating its rebuttal and rejoinder testimony in the rate case. (Motion at 2.) APS hopes
25 that the Alliance's members take the actual RFP more seriously so APS can realize from
26

1 that RFP the hoped-for benefits of economic resource additions for APS customers. In
2 either event, the Alliance's stated fears are misplaced for two very practical reasons.

3 First, APS will garner no more intelligence about the wholesale market than the
4 merchants already know and are willing to provide to APS in response to the specific
5 RFP. Thus, any insights APS receives will hardly be either original or unique. Moreover,
6 the acquisition of physical assets from possibly-distressed owners is not intended to and
7 likely will not tell either APS or the Commission much about the overall state of the
8 wholesale market. Finally, if the Alliance or its members have information about the state
9 of the wholesale market that they believe would be useful to the Commission in deciding
10 the APS rate case, the Company assumes they would offer that same information to the
11 Commission and the Company irrespective of whether APS was conducting an RFP.

12 Second, much of the information provided by bidders in response to the
13 Company's RFP will be provided on a confidential basis to protect the competitively-
14 sensitive information of the bidders and to avoid affecting the negotiations with one or
15 more entities making the "short list." This will severely limit its use in regulatory
16 proceedings, even if arguably relevant, without the consent of the information's provider.

17 **4. The RFP Schedule Proposed by the Alliance is Unrealistic and**
18 **Prejudicial to APS and its Customers**

19 The Alliance Motion suggests that APS could reissue its RFP in January with only
20 a week's delay in the final award and filing with the Commission. (Motion at Attachment
21 A.) However, it does so by cutting by more than half the time APS believes is necessary
22 to evaluate the "short list" of proposals, simultaneously conduct the necessarily extensive
23 "due diligence" on any facilities, and negotiate definitive agreements with potentially
24 more than one seller. Forcing the buyer to make an important decision in haste and on a
25 schedule dictated by the seller is a ploy known to every car salesman and insurance agent,
26 but it is hardly a formula for getting the maximum benefit for APS customers, which after
all, is (or ought to be) the whole point of this exercise.

1 Even given its evident limitations, the Alliance Motion's proposed new RFP
2 schedule is deficient in yet another respect. The Alliance suggests that PWEC could bid
3 in the expanded and reissued RFP process, but contends that this would, in its opinion,
4 require the Commission to retain an independent monitor and set up the whole elaborate
5 Track B process (Motion at 11)—a process that many participants in the November Track
6 B Workshop, including some from the Alliance, expressed a desire to avoid in future
7 APS solicitations.. This would add several months to the RFP process under the most
8 optimistic set of assumptions.

9 III. THE RATE CASE

10 1. The Company's Request to Acquire and Rate Base the PWEC Assets 11 is not a Function of their Current Market Value

12 The Company has presented testimony and exhibits that demonstrate that the
13 PWEC generation assets APS seeks to acquire and rate base were the result of a
14 reasonable and prudent resource planning process. APS has further provided evidence that
15 these same assets have been and will continue to be "used and useful" in meeting the
16 needs of APS customers. These are the sole criteria by which the Commission has judged
17 all previous APS resource additions, and the Company expects those to be the criteria
18 applied in this instance. APS has also offered equitable and operational reasons why it is
19 in the public interest to consolidate all of the enterprise's generation in a single entity
20 under a common regulatory scheme given the Commission's Track A Order blocking the
21 divestiture of APS generation to PWEC.

22 The Alliance punctuates its Motion with a number of quotes from APS testimony
23 about the state of the wholesale market and the potential for future price increases in that
24 market. Aside from these snippets being taken out of context, they in no way suggest that
25 APS has placed at issue in the rate case an RFP that did not exist until five months after
26 the Company's rate filing or that the current "market value" of the PWEC generation was

1 a consideration in the APS rate request. In fact, APS did not present in its testimony a
2 specific determination of the present market value of the PWEC assets or, for that matter,
3 of any of its existing generating resources. Moreover, even if APS had attempted to
4 interject such a ratemaking standard, this Commission would have correctly found that
5 “market” value is not “fair” value under Arizona law, and that it is the latter which the
6 Commission is obliged to consider when setting the Company’s rates. *Arizona*
7 *Corporation Commission v. Arizona Water Company*, 80 Ariz. 198, 335 P2d 412 (1959).

8 As a practical matter, the Alliance is free to offer (and APS and other parties free to
9 object to) whatever “market value” evidence the Alliance believes relevant as part of its
10 direct case on January 9th. And if it is the Alliance’s position that only the responses to the
11 Company’s RFP will provide credible evidence on this subject, the Alliance can
12 supplement its direct testimony on January 14th (the present due date for responses to the
13 Company’s RFP) and offer as evidence those RFP responses its members are willing to
14 release to the Commission and the other parties to the rate case.² Neither of these courses
15 of action requires a change in the long-standing rate case procedural schedule that the
16 Company, Staff and other intervenors have worked so diligently to meet.

17 **2. The Requested Delay in the Rate Case will Irreparably Damage the** 18 **Company**

19 Under the terms of the 1999 Settlement and the Commission’s own rate case
20 management regulation (A.A.C. R14-2-103), APS should receive a final decision on its
21 rate Application early in the third quarter of 2004. Either the bifurcation of the
22 Company’s Application or the outright delay proposed by the Alliance in its Motion
23 would make such a timely ruling impossible. And since APS receives a substantially
24 disproportionate percentage of its annual revenues (roughly a third) during a typical third
25 quarter, the delay is particularly damaging to the Company’s financial position,

26 ² APS in no way countenances or encourages collusion by the Alliance’s members on their responses to
the Company’s RFP and would hope that any attempt by the Alliance to interject these responses into the
APS rate case would be done in a manner least likely to prejudice the interests of APS customers.

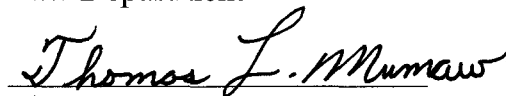
1 potentially resulting in some sixty millions of dollars of lost revenue during these
2 months.³ Moreover, even if the Commission were to authorize in such final order
3 substantially less in annual rate relief than was originally requested by APS, the delay
4 inherent in the Alliance Motion could still be very negatively perceived and received in
5 the financial community, which has repeatedly identified the regulatory uncertainty
6 surrounding the pending rate proceeding as the number one issue facing the Company.

7 8 IV. CONCLUSION

9 The Alliance Motion is inconsistent with the actions and statements of its own
10 members. The Alliance Motion is unsupported by any legal authority or practical
11 evidentiary necessity. Finally, the Alliance Motion is prejudicial to and, indeed, will do
12 irreparable harm to the interests of both APS and its customers. Thus, APS asks the
13 Commission to promptly deny the Motion, affirm the current rate case procedural
14 schedule and allow the Company to do, through its existing outstanding RFP, precisely
15 what the Commission told it to do in the Track B order, which is "to provide for the
16 continuing need of its ratepayers to maintain a reliable supply of electricity at reasonable
17 rates." Decision No. 65743 at 20.

18 RESPECTFULLY SUBMITTED this 24th day of December 2003.

19 PINNACLE WEST CAPITAL CORP.
20 Law Department

21 

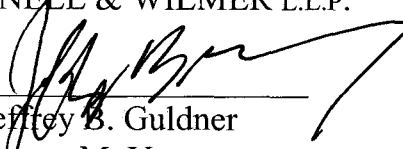
22 Thomas L. Mumaw
23 Karilee S. Ramaley

24 and

25 ³ APS has no assurance that the delay would be limited to just four months. Because of the number of
26 outside consultants involved, each of which has set aside just so much time for this proceeding, a large rate
case has great potential disassembling into a seemingly endless parade of delays and corresponding
opportunities for new issues to emerge that argue for yet more delay.

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SNELL & WILMER L.L.P.



Jeffrey B. Guldner
Teresa M. Voss

Attorneys for Arizona Public Service Company

1 ORIGINAL AND 13 COPIES OF THE FOREGOING
2 filed this 24th day of December 2003, with:

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington
6 PHOENIX, AZ 85007;

7
8 Copies of the foregoing mailed, faxed or
9 transmitted electronically this 24th day of
10 December 2003 to:

11 All Parties of Record

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13 
14 _____
15 Vicki DiCola
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APS SUMMER SUPPLY & DEMAND BALANCE

	2004	2005	2006	2007	2008	2009	2010	2011	2012
A. LOAD REQUIREMENTS									
<u>SYSTEM DEMAND</u>									
1 PEAK DEMAND	6,114	6,488	6,764	7,067	7,359	7,654	7,958	8,211	8,462
2 ANNUAL LOAD GROWTH %	6.1	4.3	4.3	4.5	4.1	4.0	4.0	3.2	3.1
<u>RELIABILITY</u>									
3 RESERVE REQUIREMENTS @ 15%	801	856	896	940	983	1,026	1,070	1,107	1,143
4 TOTAL LOAD REQUIREMENTS	6,915	7,344	7,660	8,007	8,342	8,679	9,028	9,318	9,605
B. EXISTING GENERATION & PURCHASED POWER RESOURCES									
<u>EXISTING GENERATION RESOURCES</u>									
5 APS EXISTING GENERATION ¹	5,688	5,684	5,710	5,710	5,736	5,736	5,736	5,736	5,736
6 SEASONAL VARIATION	(35)	(35)	(35)	(35)	(35)	(35)	(35)	(35)	(35)
7 TOTAL	5,653	5,649	5,675	5,675	5,701	5,701	5,701	5,701	5,701
<u>PURCHASED POWER RESOURCES</u>									
8 SRP - FIRM	295	302	310	318	326	334	342	351	360
9 SRP - CONTINGENT	62	62	62	62	62	62	62	62	62
10 ENVIRONMENTAL PORTFOLIO	12	20	23	26	27	22	23	23	24
11 PACIFICORP DIV EXCH	480	480	480	480	480	480	480	480	480
12 PPL's SUNDANCE CTs	150	150	0	0	0	0	0	0	0
13 MARKET PURCHASE ²	175	50	0	0	0	0	0	0	0
14 TOTAL PURCHASES	1,174	1,064	875	886	895	898	907	916	926
15 TOTAL RESOURCES	6,827	6,713	6,550	6,560	6,596	6,599	6,608	6,617	6,626
C. TOTAL RESOURCES OVER / (UNDER)									
	(88)	(631)	(1,110)	(1,447)	(1,746)	(2,081)	(2,420)	(2,701)	(2,979)

Note: 1) Assumes PWEAC Arizona power plants are transferred to APS
2) Current market position as of Nov. 26, 2003